

This testimony is submitted on behalf of the Milk Industry Foundation ("MIF"), which has over 100 member companies that process and market about 85% of the fluid milk and fluid milk products consumed nationwide.

As buyers and processors of milk, the members of MIF have an important interest in this hearing. Most of the milk bought and handled by MIF members is purchased under the Federal milk marketing orders promulgated pursuant to the Agricultural Marketing Agreement Act of 1937 (the "AMAA").

I am Dr. Robert D. Yonkers, Chief Economist and Director of Policy Analysis with the International Dairy Foods Association, an umbrella organization of which MIF is a constituent. I have held that position since June 1998. I hold a Ph.D. in Agricultural Economics from Texas A&M University (1989); a Masters degree in Dairy Science from Texas A&M (1981); and a Bachelor of Science degree in Dairy Production from Kansas State University (1979). I have been a member of the American Agricultural Economics Association since 1984.

Prior to taking my current position at IDFA, I was a tenured faculty member in the Department of Agricultural Economics and Rural Sociology at The Pennsylvania State University, where I was employed for nine years. At Penn State, I conducted research on the impacts of changing marketing conditions, alternative public policies, and emerging technologies on the dairy industry. In addition, I had statewide responsibilities to develop and deliver extension materials and programs on topics related to dairy marketing and policy. I have written and spoken extensively on economic issues related to the dairy industry, and I have prepared and delivered expert witness testimony to state legislatures and to Congress.

This hearing was called to consider a number of proposals that would amend the definition of "fluid milk product" in Federal Order regulation. Milk used to make "fluid milk products" is classified under the federal orders as Class I milk, which carries the highest regulated minimum price.

USDA first requested additional comments and/or proposals regarding the fluid milk product definition in August 2003, in response to a petition received from Dairy Farmers of America. On September 19, 2003, MIF submitted comments to USDA indicating its opposition to holding a hearing based on the lack of data and analysis necessary to justify any change in the regulation. USDA extended the deadline for interested parties to submit comments to January 30, 2004. This time, the National Milk Producers Federation joined with MIF to file joint comments to USDA requesting that no hearing be held, citing the lack of information about the market for beverage products containing milk and other dairy-derived ingredients. Again USDA extended the deadline for submitting comments, this time to September 30, 2004, and again National Milk Producers Federation joined with MIF to request that USDA not hold a hearing, noting that "initiating the formal rule-making process required to amend Federal Orders without further data and analysis may compromise the effectiveness of the resulting decision." USDA again extended the deadline for comments to January 31, 2005, and subsequently issued the hearing notice governing this hearing.

Consistent with our position on this issue from the start, MIF opposes any change to the fluid milk definition, because the proponents of the proposals contained in the hearing notice have failed at this hearing to provide data and analysis that would demonstrate the need for any change at this time.

MIF's philosophy toward proposed amendments to the federal order system can be simply stated. MIF believes that the proponents of such amendments carry the burden of coming forth with solid data and analysis demonstrating both the need for a change and that the proposed amendment will address that need. Anecdotal evidence or broad suppositions do not suffice.

USDA has itself adopted this approach to federal order amendments. A good example is the proposed rule issued in Milk in the Texas and Southwest Plains Marketing Areas, Docket Nos: AO-231-A56 and AO-210-A48 and DA-88-110, published June 16, 1988 (53 FR 22499), addressing (and rejecting) a proposal to amend a federal order with respect to the "producer handler" exemption. Although the proponents asserted that the exemption created a significant unfair advantage, USDA noted that "The existence of large producer-handler operations merely *implies* that the conditions for disorderly and disruptive marketing conditions *may* exist." MIF similarly notes that the mere existence of beverages that contain milk and other dairy-derived ingredients does not prove that those products either compete with beverages that meet the existing fluid milk product definition, nor that such competition has a negative impact on the market for fluid milk products or producer revenue under existing Federal Order regulations.

In the producer-handler decision, USDA went on to note that mere "concern over the *potential* of a large handler who may have the ability to become a producer-handler does not provide sufficient basis for a regulatory change." Applying this lesson here, it seems clear that the proponents of any change to the fluid milk product definition must demonstrate using actual data and analysis that products not meeting the current fluid milk product definition are having an impact on the market, not merely that they have the

potential to do so. Without such data and analysis, there cannot be a sufficient basis to justify a regulatory change.

USDA in the producer-handler decision made another apt observation, pointing out that "not sufficient time has elapsed between the time that Pure Milk acquired producer-handler status and when the hearing was held" to evaluate the economic impact. MIF has similarly and consistently maintained that the market for beverages containing milk and dairy-derived ingredients is in its infancy, noting in a January 30, 2004 letter to USDA that "At such time that study and experience provide a more conclusive basis for redefinition of Class I products, the dairy industry can ask the Department to address the issue."

USDA's decision in the producer-handler decision to which I have referred is only one example of the approach to decision-making that should also be applied here. For example, in its 1998 decision rejecting proposals to establish a floor price, USDA concluded that "The data contained in the record of the public hearing in this proceeding provide no basis to expect that an adequate supply of milk for fluid use will not be available nationwide. Therefore, the record does not support adopting the proposal, which would encourage more milk." Again, USDA placed the burden on the proponents to come forward with hard data and analysis justifying the change, and in its absence, declined to adopt the proposed order amendment. Milk in the New England and Other Marketing Areas, Docket Nos. AO-14-A68, DA-98-01, published June 12, 1998 (63 FR 32147). Similarly, proponents of changes to the fluid milk product definition in this hearing have failed to demonstrate any need to do so.

Let me be more specific as to the data and analysis that I or any other dairy economist would need to see before determining whether an economic change in the fluid milk product definition were needed.

1. A quantification of the market share held by beverages which do not fall under the current fluid milk product definition but would be included under any proposed change. Speculative conjecture of the hypothetical potential for such products to gain significant market share in the future is not sufficient. There has been no quantitative market data demonstrating that beverage products not meeting the current fluid milk product definition have a significant market share. Without such information, there can be no analysis of the competitive impact such products are having on the market for beverages which meet the existing fluid milk product definition.
2. An analysis of the cross price elasticity of demand between beverages which meet the existing fluid milk product definition and beverages which would meet any of the proposed changes to the fluid milk product definition. This is the necessary economic test to determine whether two such product types are truly in competition with each other as substitutes in the marketplace. Such competition is a prerequisite to reaching any conclusion regarding whether other products are being placed at an unfair competitive disadvantage, or whether disorderly marketing conditions exist. Merely looking at how the two products are packaged or where in the retail store they are sold is not sufficient to demonstrate the products compete in the marketplace. I believe that data necessary to perform this analysis could have been obtained and analyzed by the proponents, at least with respect to some of the products that would be re-classified as fluid milk products under the proposed amendments. And even if

the fact that no empirical evidence of such cross price elasticities has been presented at this hearing were due to the lack of the data necessary to conduct such an analysis, this would simply demonstrate that the market share of those beverages is just too small today to warrant regulatory attention.

3. An analysis of the own-price elasticity of demand for those beverages. The most obvious economic test to determine the impact of a regulatory change, which would change the cost of ingredients use in beverages with milk and dairy-derived ingredients, is to study how economic agents react to such a change. The first inquiry would address empirical evidence of the impact of consumer response to the increased cost of the product--in economist's terms, own price elasticity of retail demand. That inquiry would be necessary to assess the impact of the regulatory change on the pool--specifically, would the positive impact on pool revenues resulting from a higher minimum price for raw milk be more than offset by the decline in sales of the product resulting from the higher price for the product.

One would also need to assess the impact of the higher regulated price on the ingredient formulation of the product. This requires empirical analysis of the input substitution between dairy and non-dairy ingredients in those beverages. Once again, the issue is whether the positive impact on pool revenues resulting from a higher minimum price for raw milk would be more than offset by the decline in use of dairy ingredients in the product because of the higher price for the dairy ingredients. Without such an analysis, there can be no credible testimony regarding the impact on producer revenue at Federal order minimum class prices from the proposed regulatory change.

Analyzing the economic impact of changing the fluid milk product definition requires actual market data and empirical analyses, not simply conjecture and speculation. Those data and analyses have not been presented at this hearing. There is, therefore, no justification for changing the fluid milk product definition at this time.